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equipment and facilities, sharing of personnel, joint research and development and sharing of information between a BOC and its affiliates until such time as meaningful competition has emerged in the local competition market, and that the Commission should require all Title II services provided by a BOC to its interLATA affiliate to be taken at generally available tariffed rates, terms and conditions.⁴⁴

As the Commission has noted, "[a]fter a BOC affiliate enters competitive markets, that BOC will become subject to the economic incentives of the marketplace and therefore may have an incentive to favor its competitive affiliate or to take actions that could weaken the affiliate's rivals."⁴⁵ These economic incentives to manipulate costs to the detriment of competitors clearly justify the imposition of the Commission's cost allocation and affiliate transactions rules to any joint marketing of interLATA and local exchange services.

⁴⁴ Comments of the Telecommunications Resellers Association, CC Docket No. 96-149, filed August 15, 1996.

⁴⁵ Notice of Proposed Rulemaking, FCC 96-308, released July 18, 1996, at ¶ 65.

5. Audit Requirements (§§ 92 - 93)

TRA supports the Commission's conclusion that the independent auditor's report required by Section 272(d) of the 1996 Act should provide information concerning

(1) the scope of the work conducted, with a description of how the affiliate's or joint venture's books were examined and the extent of the examination; (2) the auditor's conclusion whether examination of the books has revealed compliance or non-compliance with the affiliate transactions rules and any non-discrimination requirements in the Commission's rules; (3) any limitations imposed on the auditor in the course of its review by the affiliate or joint venture or other circumstances that might affect the auditor's opinion; and (4) a statement by the auditor that the carrier's cost allocation methodologies conform to the Communications Act of 1934, as amended, and the Commission's rules and that the carrier has accurately applied the methodologies described in those rules.⁴⁶

TRA notes that the above standards are no more intrusive (or costly) on the company subject to audit than the "positive opinion" audit upheld by the Commission in its Joint and Common Costs Reconsideration.⁴⁷ The Commission there held that

[i]n determining whether a carrier's cost allocation practices are in conformity with its manual, independent auditors are currently required to provide us with a positive opinion that the manual is being followed, that the cost allocations performed are correct, and that the cost allocations are the product of accurate methods. We required a positive opinion on these subjects because we felt that, as a tool for our monitoring of cost allocations, the independent audit was an indispensable factor in our ability to enforce the rules we established. . . The purpose of the independent audit is to assist us in determining if our Rules, which are designed to protect ratepayers, are being followed.⁴⁸

Through this rulemaking proceeding, the Commission has the opportunity to further refine its previous accounting safeguard measures to create even more accurate

⁴⁶ Notice at ¶ 93.

⁴⁷ Joint Costs Reconsideration Order at ¶ 185.

⁴⁸ Id. at ¶¶ 84 - 85.

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mechanisms for the monitoring of cost allocations. TRA has endeavored in these Comments to suggest means by which the Commission may augment the accounting documentation which must be maintained by carriers to demonstrate their compliance with the Commission's cost allocation and affiliate transaction rules. An independent audit addressing the areas outlined by the Commission above, based upon such carriers' supplemented audit trail documentation, will be capable of providing an accurate representation of whether the carrier has fulfilled its obligations under the 1996 Act. The Commission should require that the audit including a "positive opinion" concerning the carrier's obligation to charge its affiliate (or impute to itself) "an amount for access to its telephone exchange service and exchange access that is no less than the amount charged to an unaffiliated interexchange carrier"⁴⁹ and its obligation to provide interLATA or intraLATA facilities and services to an interLATA affiliate only "at the same rates and on the same terms and conditions" as those services are provided to all carriers, and subject to the further restrictions that "the costs are appropriately allocated."⁵⁰

B. SAFEGUARDS FOR INTEGRATED OPERATIONS

1. Section 271 - InterLATA Telecommunications Services (¶¶ 37 - 43)

The Commission observes that "a carrier entering or continuing to participate in a nonregulated market will have an increased incentive to shift the costs and risks of its

⁴⁹ 47 U.S.C. § 272(e)(3).

⁵⁰ 47 U.S.C. § 272(e)(4).

competitive activities to these regulated services if such shifting permits the carrier to increase the rates for these regulated services"⁵¹ and that "a carrier subject to rate-of-return regulation may have an incentive to engage in predatory pricing, if losses from below-cost pricing in the competitive market can be shifted to its regulated cost of service".⁵² Precisely because the incentive to subsidize the provision of competitive services is so great, the provision of integrated interLATA services by BOCs or ILECs warrants close regulatory scrutiny.

a. Integrated Provision of InterLATA Services (¶¶ 39 - 40)

Pursuant to the Commission's BOC Out-of-Region Order,⁵³ BOCs may provide out-of-region interstate, interexchange services on an integrated basis, although doing so would subject the carrier to dominant carrier regulation. TRA supports the Commission's conclusion that regulated services outside the scope of local exchange and exchange access services provided on an integrated basis by a BOC must, at a minimum, remain subject to the Commission's cost allocation rules. TRA further believes that an identical risk of cost misallocation would be present if an independent local exchange carrier rather than a BOC were providing the out-of-region interstate interexchange services. Accordingly, in the event independent local exchange carriers are permitted to provide out-of-region interstate interexchange services on an integrated basis, the Commission's cost allocation rules also should apply to the provision of those services by independent local exchange carriers.

⁵¹ Notice at ¶ 13.

⁵² Notice at ¶ 16.

⁵³ Bell Operating Company Provision of Out-of-Region Interstate, Interexchange Services, Report and Order, CC Docket No. 96-21, FCC 96-288 (July 1, 1996).

TRA further encourages the Commission to strengthen the force of its cost allocation rules by classifying regulated services other than local exchange and exchange access services provided by BOCs on an integrated basis as nonregulated activities for Title II accounting purposes. TRA submits that treating as nonregulated all currently regulated BOC activities outside the scope of local exchange and exchange access services, when those services are provided on an integrated basis, will best ensure that misallocation of these services may be readily detected. The modification will also lessen the likelihood that costs associated with these services will be "inadvertently" attributed to a cost category assigned to local exchange and exchange access customers.

**b. Imputed Access Charges and Proper
Cost Allocation (§§ 41 - 42)**

Section 272(e)(4) mandates that BOCs providing interLATA or intraLATA facilities or services on an integrated basis must provide them to their own internal operation at the same rates as those facilities or services are made available to *all* carriers.⁵⁴ As the Notice recognizes, the rates charged by the BOC will not be uniform but will instead vary from carrier to carrier. In those cases, the rate which must be imputed to the BOC for provision of like services for its own internal operation must be the highest tariffed rate for those facilities or services. Only in this way would the mandate of Section 272(e)(4) be realized. Allowing a BOC the flexibility to choose among various services rates -- rates which are not available to every carrier -- would afford the carrier "a degree of selectivity" similar to that which the Commission found inappropriate in its Joint and Common Costs

⁵⁴ 47 U.S.C. § 272(e)(4).

Order.⁵⁵ When considering the appropriate valuation method for asset transfers between affiliates, the Commission responded to AT&T's suggestion that "fair market value is best determined from actual market transactions rather than from price lists held out to the general public" by holding that "[t]his approach affords the carrier a degree of subjectivity in selecting the 'actual market transaction' for the asset transfer, and as such detracts from our ability to monitor the carrier's asset transfers."⁵⁶

When the transfer involves a service rather than an asset, the service is valued first, at tariffed rates, if the service is available at tariffed rates to non-affiliates, or at a prevailing company price, and only if neither a tariffed rate or a prevailing company price is available, at fully distributed costs.⁵⁷ Thus, whether an asset or a service is transferred, the preferable valuation method remains the tariffed rate.

Imputing costs at the BOC's tariffed rate would be consistent with a principal objective of the Commission in the Joint and Common Costs Order, and a similar objective which underlies the Commission's cost allocation and affiliate transactions rules -- "prevention of cost shifting to ratepayers by means of improper transfer pricing".⁵⁸ Valuation of assets is determined by looking first to "prevailing price lists held out to the general public in the

⁵⁵ Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, Report and Order, CC Docket No. 86-111, 2 FCC Rcd. 1298 ("Joint and Common Costs Order") at ¶ 295.

⁵⁶ Id. at ¶ 295.

⁵⁷ Notice of Proposed Rulemaking, CC Docket No. 93-453, 8 FCC Rcd 8090 ("Affiliate Transactions Notice") at ¶ 6.

⁵⁸ Joint and Common Costs Order at ¶ 290.

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normal course of business or to filed tariffs."⁵⁹ The Commission further held that "[i]f a carrier provides a service to an affiliate pursuant to a tariff . . . the affiliate will, of course, pay the tariff charge and the actual revenues will be recorded."⁶⁰ Applying such a standard in situations where the BOC provides services for its own internal use clearly satisfies the Congressional intent behind Section 272(e)(4) by ensuring that the neither the BOC nor its local exchange service customers is unfairly favored or unfairly disfavored by virtue of the BOC's unique position as simultaneous service provider and service obtainer.

⁵⁹ *Id.*

⁶⁰ *Id.* at ¶ 299.

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III.

CONCLUSION

By reason of the foregoing, the Telecommunications Resellers Association urges the Commission, urges the Commission to adopt accounting safeguard rules to be applicable to services offered pursuant to Sections 260 and 271 through 271 of the 1996 Act consistent with the foregoing comments.

Respectfully submitted,

**TELECOMMUNICATIONS
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